

Pre-issuance review

Auditee: Randfontein Municipality

Period-end: 30 June 2011

Date: 8 December 2011

W/P reference:

Purpose

The purpose of this working paper is to facilitate compliance with the requirement of ISA 220 and the AGSA quality control manual regarding the performance of pre-issuance review on applicable audits.

ISAs addressed in this working paper

ISA 220: 19(b)&(c), 20 - 22 and 25

Completion of the working paper

The working paper should only be completed for audits on which pre-issuance reviews are required in terms of the established criteria.

The working paper consists of four sections:

- A. Conclusions from the pre-issuance review.
- B. Representations of the pre-issuance reviewer and the senior manager (SM).
- C. Findings from the pre-issuance review.
- D. Pre-issuance review procedures performed.

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| A. Conclusions from pre-issuance review |
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Based on the procedures performed, nothing has come to my attention that causes me to believe that the significant judgment made by the audit team and their conclusions reached in formulating the attached auditor's report dated 8 December 2011 were not appropriate.

Annalien Carstens

Name of Reviewer



Signature

08-Dec-11

Date

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| B. Representations |
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| B1 Representation from pre-issuance reviewer |
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I confirm that, except as documented below:

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| I am independent from both the audit and the auditee and have not been involved with any significant matters regarding the audit nor have I participated in any decision-making on behalf of the audit team. |
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| I performed <u>all</u> of the review procedures required by the AG. |
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| As part of the review, I held discussions with the senior manager (SM) and the audit team and I discussed all findings with the SM. |
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| I corroborated, through review of documentation, whether <u>all</u> the high-risk findings from the review have been resolved. |
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| I differed in opinion from the SM on the following findings: |
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- *List findings and refer/link to findings in Section C*

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| The difference's) was resolved as follows: |
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- *Detail on process followed and decisions made and any outstanding/unsatisfactory matters*

Annalien Carstens

Name of Reviewer



Signature

08-Dec-11

Date

| | Description of finding* (and further comments by reviewer is disagreement exists)* | Ref.* | Classification* High/ Low | Agree? Y/N # | Reason for disagreement (if applicable)# | Resolved? Y/N\$ | Date of resolution \$ |
|---|--|----------------|------------------------------|-----------------|---|--------------------|-----------------------------|
| 1 | No evidence that the susceptibility of the Financial Statements being misstated as a result of fraud was discussed with the MM, the Mayor or the Head of the Audit Committee. The finding it still valid, only the CFO was present | E2 | Low | N | For the minutes of meeting where fraud was discussed refer to E.2.32 | Yes | 08-Dec-11 |
| 2 | The risk relating to irregularities in the way in which personnel are appointed not included in the risk register. | B15.1 I2.1 | Low | Y | Corrected | Yes | 03-Dec-11 |
| 3 | The following is an additional risk not included in the risk register: Unspent conditional grants = R27 099 027 Overdraft = R2 831 856. This means that the municipality must have used the conditional grants to fund operations. | AFS I2.1 | Low | Y | Corrected | Yes | 03-Dec-11 |
| 4 | Going concern risk should be included in the risk register the deficit is not only a result of implementation of GRAP the municipality is in an overdraft position. Current assets R70 m; Current liabilities R172 m = 1:2.46 therefore not healthy. | I2.1 E1.10 | Low | N | There is no going concern risk as the municipality is funded by treasury. | Yes | 03-Dec-11 |
| | Execution | | | | | | |
| 5 | From review of the lead schedule and working paper, only unspent amounts on MIG projects (R16 133 398) is audited. No audit work found relating to the rest of the balance of R16 133 398. It is not clear how the existence, rights & obligations, completeness and valuation & allocation of unspent conditional grants were audited. Please indicate where exactly this was done, as it is difficult to see on the wp | J1.1 J1.7 | High | | Done, For work performed on this refer to procedure summary K.2.PS two procedures named unspent conditional grants referenced to working paper K2.12 and K.2.20 | Yes | 08-Dec-11 |
| 6 | From review of the work done it does not seem as if the unit price was traced back to actual invoices to ensure the unit price is correct. Also formulas of calculations have not been included as evidence that it has been re-calculated based on weighted average. | J2.3 | Low | Yes | For work performed on agreeing the amount to the invoices refer to wp J.2.3 sheet E. For recalculations refer to J.2.3. sheet L | Yes | 03-Dec-11 |
| 7 | Provision for doubtful debt, the amount per the AFS is now R202 562 921 | J3.2 EX.164 | Low | Yes | Corrected the figure on Ex 164 to R 202 562 921. | Yes | 03-Dec-11 |

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|----|--|----------------------------------|-----|-----|---|-----|-----------|
| 8 | Simply creating an allowance for bad debts by taking a fixed percentage of the gross debtors balance is not acceptable unless there is very strong historical evidence that the percentage chosen is an accurate reflection, in which case only those debtors displaying worrying characteristics will have to be considered individually. Due to the fact that 81% of debtors have been provided for as doubtful, the finding has been cleared. Notwithstanding above, upon inspection of EX164 raised it seems that the prior year calculation was received and the auditor's recalculations were compared to that, therefore there is no evidence that the current year's provision calculation from municipality was agreed to the auditor's calculation to see if it's adequate/accurate. | J3.2 Provision for doubtful debt | Low | No | Overview of how the assessment on provision for bad debts done has been indicated on the working paper J.3.2.provision for doubtful debt.For recalculations performed refer to the J.3.2 tab named recalculation of provision | Yes | 08-Dec-11 |
| 9 | 109 of the sample of 211 could not be audited. M1 = The procedure not applicable as this resulted from debtors who were overpaid. These debtors should have been classified as liabilities and not debtors with credit balances, therefore misclassified. All "debtors who were overpaid" items should have been removed from the population and alternative sample items should be selected in order for the sample to be representative of the population tested. | J3.1 | Low | Yes | Corrected | Yes | 03-Dec-11 |
| 10 | No evidence that the indigent application forms were checked in order to ensure that the indigent debtors are valid and complete | J3.2 | Low | Yes | Indigent application forms were obtained and inspected. The forms were well completed. For validity, they were not signed by the relevant official. Ex 99 was raised. Refer to referenced wp. | Yes | 03-Dec-11 |
| 11 | It is not clear where balances transferred from trade payables R13 379 594 were tested. Not sure why such debtors are classified as receivables from non-exchange transactions also no test to ensure all receivables from non-exchange transactions in fact meet the definition. Accept, however, the amount should be included in column E as well as it relates to audit adjustments | J3.2 | Low | Yes | The R 13 379 594 has been added in the Lead Schedule working paper J.3.2. The supporting evidence has not been provided. Ex 213 has been raised. This arose from the audit adjustment after audited AFS. | Yes | 03-Dec-11 |
| 12 | As per the wp on Retention monies - in order to test the balances in the AFS a sample will be chosen from the age analysis. The test then tests payments made. The objective of the test is to test the balance of R5 151 567 as at 30 June. The sample value is = R43 062 058??? | J4.1 Trade creditors | Low | Yes | The work has been performed on the WP J.4.6 | Yes | 03-Dec-11 |
| 13 | Accept, however a hyperlink should be added from sheet B in J4.1 to wp J4.6 where retention monies was audited and trade payables sheet's objective should be corrected as it still refers to retention monies In the absence of an accrual listing alternative procedures must be performed such as tracing payments after year-end back to invoices or confirming that 12 invoices were paid for expense items like Eskom accounts. | EX.167 J4.1E | Low | Yes | 12 Month payments were tested on the WP K.7.3 | Yes | 03-Dec-11 |
| 14 | The population value does not agree to the AFS and the lead it may result in an incorrect sample being tested. | J11.1 A | Low | Yes | The working paper has been corrected with the amount on the financial statement. | Yes | 03-Dec-11 |

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| 15 | No evidence that the prior year adjustment to the value of R57 526 253 was audited. Further when calculating the difference of the Net Asset Adjustment in note 38 (just before note 39) between previously disclosed of R2 520 460 431 and the new balance of R2 582 036 261 is R61 575 830 and NOT R57 526 253. | J12 ST of Changes in Net Assets | High | | For work performed on this refer to wp J12.2 sheet named Net restatement SFP's. | Yes | 08-Dec-11 |
| 16 | No audit work performed to ensure that the short-term portion of the finance lease obligation was correctly calculated. Please show where it was done in wp J14.2 Furthermore, the only disclosure procedure that was carried out forms actually part of the normal substantive testing procedures, therefore it is not clear whether the disclosure was properly tested. Please provide your response to this | J14.PS | Low | Yes | Reperformed the lease current portion refer to WP and for the disclosure refer to J14.PS under the procedure summary procedure named Disclosure. For work performed on short term portion of the lease refer to wp J14.3 tab named short term portion lease. | Yes | 08-Dec-11 |
| | Execution - Fixed assets | | | | | | |
| 17 | The following risks was identified on biological assets: 1. Asset register of cows not agree to the valuation report. 2. Reconciliations aren't reviewed. I could not observe where the risks were addressed, as the valuation report was not compared to the asset register and the reconciliations performed by management was not inspected. | J5.2 | Low | Yes | Done | Yes | 03-Dec-11 |
| 18 | Intangible assets: Servitudes. I could not observe if testing was performed to determine if the servitudes meet the definition of an intangible asset. | J5.35 | High | Yes | Done | Yes | 03-Dec-11 |
| 19 | A risk was identified on journal processing that the supporting documentation is not sufficient and the figures do not agree. I could not observe where this was tested. Only one journal was tested in respect of finance leases. | J5.35 | Low | | Done | Yes | 03-Dec-11 |
| | Execution - Disclosure items | | | | | | |
| 20 | Legal confirmations were not obtained from the following law firms representing the municipality in various cases: - Van Ryneveld Bhiko Scott Inc - Noveri Eddie Kubayi Inc - Redelinghuys Attorneys - Thaananyane Attorneys | L2 | High | Yes | All the legal confirmations have been received from the municipal attorneys and added under L.2PS. Except for Redelinghuys however as per telephonical conversation with the lawyers there are no matters outstanding from their side. | Yes | 03-Dec-11 |
| 21 | It does not seem as if Related Party disclosure was tested. | L | Low | Yes | A related party working papers has been completed Refer to L.6. | Yes | 03-Dec-11 |
| 22 | It does not seem as if directors and senior management emolument disclosure was audited (the work done in section K does not meet the re-performance criteria). | L | Low | Yes | Key management personnel working paper has been completed. Refer to wp K.6.30. | Yes | 03-Dec-11 |
| 23 | No evidence that financial instrument disclosure was audited. | L | Low | | The financial instrument working paper has been completed. Refer to L.4.2. | Yes | 03-Dec-11 |
| 24 | It does not seem as if deviations to supply chain management disclosure in terms of the MFMA was audited. | L | Low | Yes | The deviations working paper has been completed. Refer to K.1.21 | Yes | 03-Dec-11 |

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| 25 | It does not seem as if GRAP 24 budget vs actual disclosure was audited. | L | Low | Yes | The disclosure working paper has been completed L.4.3. | Yes | 03-Dec-11 |
| 26 | For the completeness testing of commitments, only three contracts were selected. It is unclear whether sufficient, appropriate audit evidence was obtained as the risk factor is unknown and testing only 3 items may be insufficient. Furthermore, the record of work done is not correct, the procedure states that contracts should be selected from the register and followed through to the schedule. | L3.1 | Low | Yes | The schedule of completeness has been completed and more testing has been done. Refer to L.3.1. | Yes | 03-Dec-11 |



REPORT OF THE AUDITOR-GENERAL TO THE GAUTENG PROVINCIAL LEGISLATURE AND THE COUNCIL OF THE RANDFONTEIN LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Randfontein Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, as set out on pages ... to

Accounting Officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003) (MFMA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), section 126(3) of the Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and General Notice 1111 of 2010 issued in Government Gazette 33872 of 15 December 2010. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

7. The municipality did not review the residual values and useful lives of property plant and equipment at each reporting date in accordance with Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment*, evidenced by infrastructure assets with a gross carrying amount of R8 205 417 (2010 R4 356 956) being included in the financial statements at a zero net carrying amount whilst still being in use. Because of the nature of these assets, I was unable to confirm or verify by alternative means the value of property plant and equipment included in the financial statements at R2 613 490 871 (2010: R2 643 685 743). Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of property, plant and equipment.
8. The Property Plant and Equipment balance of R2 613 490 871 (2010: R2 643 685 743), as disclosed in note 9 to the financial statements, does not agree to the balance of 2 592 142 271 as per the asset register. The entity did not reconcile the difference of R3 297 901 between the financial statements and the underlying accounting records. Consequently, the Property Plant and Equipment balance is overstated by R3 297 901, I was unable to determine the effect on the other account balances or classes of transactions contained in the financial statements.
9. Municipal property included in the asset register to the amount of R75 143 692 could not be reconciled to the deeds report, therefore the properties were not registered in the name of the Randfontein Local Municipality. The municipality's records did not permit the application of alternative audit procedures to obtain sufficient and appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to property, plant and equipment.

Statement of changes in net assets

10. The corresponding figure for accumulated surplus stated in the statement of changes in net assets has been restated by R3 420 344 in order to address a prior year misstatement. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the accumulated surplus corresponding figure of R2 578 202.916.

Cash flow statement

11. Presentation of a cash flow statement, summarising the entity's operating, investing and financing activities, is required by Standard of Generally Recognised Accounting Practice, GRAP 2, *Cash flow statements*. The net cash flow from operating activities of R22 453 478 as presented in the cash flow statement was not adjusted for the non-cash items to the amount of R21 230 167 included in the statement of financial performance. The net cash flows from operating activities in the cash flow statement are overstated by R21 230 167. Non-cash movements to the amount of R11 743 772 could not be reconciled to any notes in the annual financial statements.

Opinion

In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Randfontein Local Municipality as at 30 June 2011 and its financial performance and cash flows for the year then ended, in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003) (MFMA).

Emphasis of matters

I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

12. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during 30 June 2011 in the financial statements of Randfontein Local Municipality at, and for the year ended, 30 June 2010.

Material losses

13. As disclosed in note 29 to the financial statements, material losses to the amount of 24 755 854 (2010: R22 350 565) and R1 779 084 (2010: R3 311 263) were incurred as a result of electricity and water losses respectively.

Material impairments

14. As disclosed in note 3 to the financial statements, material losses to the amount of R329 956 165 were incurred as a result of a write-off of irrecoverable trade debtors.

Unauthorised and irregular expenditure

15. As disclosed in note 41 to the financial statements, the municipality incurred unauthorised expenditure amounting to R53 304 059 in excess of the approved budget which is in contravention of Section 15(b) of the the Municipal Finance Management Act.



16. The municipality incurred irregular expenditure of R24 481 156 due to expenditure being incurred in contravention of the DORA as the amount was spent for purposes other than the intended purposes for the grants allocated.

Significant uncertainties

17. With reference to note 37 to the financial statements, the municipality is the defendant in a number of legal claims. The ultimate outcome of the matters cannot presently be determined. Consequently no provision for any liability that may result has been made in the financial statements.

Material underspending of conditional grants

18. The municipality has materially underspent the budget on conditional grants to the amount of R 27 099 027.

Additional matter

19. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

20. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

Usefulness of information

The reported performance information was inadequate in respect of the following criteria:

- Consistency: The reported objectives, indicators and targets are consistent with the approved integrated development plan.
 - Measurability: The indicators are well defined and verifiable, and targets are specific, measurable, and time bound.
21. The following audit findings relate to the above criteria:
- Reported performance against predetermined objectives is not consistent with the approved integrated development plan, service delivery and budget implementation plans.
 - For the selected objectives, 100% of the planned and reported targets were not:
 - specific in clearly identifying the nature and the required level of performance;
 - measurable in identifying the required performance;
 - time-bound in specifying the time period or deadline for delivery.

Reliability of information

The reported performance information was deficient in respect of the following criteria:

- **Validity:** The reported performance did not occur and does not pertain to the entity
- **Accuracy:** The amounts, numbers and other data relating to reported actual performance have not been recorded and reported appropriately
- **Completeness:** All actual results and events that should have been recorded have not been included in the reported performance information

The following audit findings relate to the above criteria:

22. The content of the integrated development plan is incomplete

- The integrated development plan did not include the key performance indicators and performance targets determined in according to its performance management system, as required by sections 26(i) and 41(1) (b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

Compliance with laws and regulations

Material adjustments to financial statements

23. Contrary to the requirements of section 122 of the MFMA, the municipality did not fairly present the financial statements submitted on 31 August 2011 as the financial statements were subject to material audit adjustments.

Procurement and contract management

24. Contrary to the requirements of section 122(1) (l) (iii) of the MFMA, the municipality did not ensure the barring of persons whose tax matters are not cleared by South African Revenue Service from participating in tendering or other bidding as the municipality has allowed suppliers who are non registered VAT vendors to participate in the procurement processes of the municipality.

Budgets

25. Section 15(b) of the the Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003) (MFMA) requires the entity to incur expenditure only within the limits of the amounts appropriated for the different votes in an approved budget. In aligning the budget to the GRAP 17 requirements, the municipality incurred expenditure in excess of the limits of the amounts provided for in the votes on the approved budget, as required by section 15 of the MFMA.



Payments not made within 30 days of receipt of invoice

26. Contrary to the requirements of Section 65 (2) (e) of the MFMA, the accounting officer of the municipality did not in all instances pay certain creditors within 30 days from receipt of invoice.

Publishing of annual report of the municipality

27. Contrary to the requirements of Section 46 (2) (e) of the Municipal Systems Act, the municipality did not make public the annual report of the municipality as the necessary approval from the council was not obtained.

Human resource management and compensation

28. The employees worked overtime in excess of the maximum hours stipulated in the Basic Conditions of Employment Act, 1997(Act No 75 of Act of 1997) (BCEA).

IDP key performance indicators

29. Contrary to the requirements of Section 26 (1) of the Municipal Systems Act, the IDP document of the municipality did not contain key performance indicators and performance targets.

Establishment of a performance management system

30. Contrary to the requirements of Section 26 (h) of the Municipal Systems Act, the IDP of the municipality did not include a financial plan which contains a budget projection for at least the next three years and indicates the resources available for capital development projects and operational expenditure.

INTERNAL CONTROL

In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

- There was inadequate exercise of oversight responsibility regarding financial and performance reporting and compliance and related internal controls.
- The leadership did not adequately establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes and responsibilities.
- There was inadequate monitoring of progress of implementation of action plans to address internal control deficiencies.

Financial and performance management

- There was inadequate implementation of proper record keeping controls, in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting. This resulted in certain instances where financial and performance reports were not supported and evidenced by reliable information.
- There was inadequate review and monitoring of compliance with applicable laws and regulations

Governance

- Management did not ensure that adequate risk assessments, including consideration of IT risks and fraud prevention, are conducted.
- Management did not ensure the internal audit unit is adequately resourced with an internal audit manager for the period under review.
- Adequate oversight over the effectiveness of the internal control environment including financial and performance reporting and compliance with laws and regulations was not exercised.

OTHER REPORTS

Investigations

31. There were a number of investigations being conducted into alleged financial mismanagement and non-compliance with supply chain management processes in the awarding of contracts and the irregular appointment of staff which were still ongoing at the reporting date.

Johannesburg

12 December 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence